

MICHIGAN WISCONSIN PIPELINE CO., INC.

IBLA 80-318

Decided April 22, 1981

Appeal from decision of the Acting Deputy Commissioner, Bureau of Indian Affairs, affirming order requiring inclusion of tax reimbursements for royalty computation purposes. IND-21-O&G.

Affirmed.

1. Oil and Gas Leases: Royalties

In determining the amount of royalty due to the United States from an oil and gas lease, it is proper for the Geological Survey to use a base value which includes both the purchase price paid for the natural gas and the amount of severance taxes paid by the purchaser directly to the State where, under Oklahoma law, the purchaser is authorized to deduct the amount of taxes paid from the amount paid to the producer.

APPEARANCES: William J. Legg, Esq., Tulsa, Oklahoma, for appellant.

OPINION BY ADMINISTRATIVE JUDGE HARRIS

Michigan Wisconsin Pipeline Company, Inc., has appealed from a decision of the Acting Deputy Commissioner, Bureau of Indian Affairs (BIA), dated November 29, 1979, affirming an order by the Acting Area Oil and Gas Supervisor, Geological Survey (Survey), dated August 9, 1979, requiring appellant "to include tax reimbursements as part of the gross value when computing royalty payments." Noting that the transactions in appellant's lease account indicated that it had failed to do so, Survey required appellant to pay "all additional royalties due" within 30 days of receipt of the order and compute all future royalty payments "on values which include tax reimbursements."

Essentially, Survey directed appellant to include the value of certain State severance taxes ^{1/} paid by purchasers of natural gas from its leasehold unit as part of the value basis of its production for the purposes of computing royalty under 30 CFR 221.47. Appellant's lease, 18-005982, is subject to a communitization agreement whereby all lessees, private and Federal, share in the benefits and costs of production.

Applying the rationale in the case of Wheless Drilling Co., 13 IBLA 21, 80 I.D. 599 (1973), the Acting Deputy Commissioner, BIA, upheld Survey's order requiring appellant to include the value of the State severance taxes in its royalty basis, stating:

The principle applied by IBLA in Wheless was that royalty "value" includes the amount of the severance tax paid by the buyer to the seller. Appellant alleges that the tax here involved is paid directly by the buyer. However, this is an irrelevant distinction. The payment of the tax by the buyer inures to the benefit of the seller because the Pipeline Company "* * *" does not have to reach into its own pocket to pay the severance tax liability." Amoco Production Co., 29 IBLA 234, 237 (March 25, 1977). [Emphasis added.]

Decision at 5.

The Board's recent decision in Hoover & Bracken Energies, Inc., 52 IBLA 27, 88 I.D. 7 (1981), which specifically applied Wheless Drilling Co., *supra*, is dispositive of the present case. The facts in this case and in Hoover & Bracken Energies, Inc., are virtually identical. Appellant in this case adopted by reference the arguments made by Hoover & Bracken in its appeal. As those arguments were fully discussed in Hoover & Bracken Energies, Inc., *supra*, we need not discuss them again in this case.

[1] We hold that in determining the amount of royalty due to the United States from an oil and gas lease, it is proper for Survey to use a base value which includes both the purchase price paid for the natural gas and the amount of severance taxes paid by the purchaser to the State where, under Oklahoma law, the purchaser is authorized to deduct the amount of taxes paid from the amount paid to the producer. *Id.*

Appellant insists on appeal that the action of the oil and gas supervisor "is a violation of the Contract Clause, and the Fifth

^{1/} Specifically, the State severance taxes are a gross production tax and an excise tax, which the purchaser of the natural gas is required to pay and which he may then deduct when making settlement with the producer. Okla. Stat. Ann. tit. 68, §§ 1001, 1009(d), 1102 (West).

Amendment of the United States Constitution." Its constitutional arguments are apparently premised on what it characterizes as the "inequity of the situation." It alleges that the decision "ensures that the producer who has negotiated a gas purchase contract, including a tax reimbursement for himself and his lessors, does not in fact receive all such reimbursement, and a lessor who does not pay taxes receives the benefit of such reimbursement" (Statement of Reasons at 3). 2/

Appellant argues that this situation is in derogation of a "substantial contractual right" and does not serve a legitimate public purpose. Furthermore, appellant argues it constitutes a "taking" of private property (the tax reimbursement) without just compensation. Finally, appellant argues that Survey discriminates between Federal lessees who pay the increased royalty payment and private lessees who do not.

Appellant's arguments indicate a misconception of the nature of the Federal royalty interest. The collection of an overriding royalty interest by the Federal Government on the value of the production of natural gas has no bearing on the rights and obligations owing between parties to a purchase contract for the natural gas. In this case, appellant received the full benefit of its contract, that is, the proceeds from the sale of the natural gas minus a deduction for the value of the tax paid by the purchaser. The collection of the royalty interest was a separate matter.

Furthermore, collection of the royalty does not constitute a taking. As we stated in Hoover & Bracken Energies, Inc., supra at 33:

It is well recognized that the Secretary of the Interior has considerable latitude in determining what is the "value" of production from a lease on which royalty payments are made. Amoco Production Co., 29 IBLA 234, 236 (1977); Wheless Drilling Co., supra at 31; 30 U.S.C. § 226(c) (1976) and 30 U.S.C. § 189 (1976). *

* * In California Co. v. Udall, 296 F.2d 384 (D.C. Cir. 1961), the Secretary's

2/ As pointed out in Hoover & Bracken Energies, Inc., supra at 35:

"[T]he applicable Oklahoma statutes provide that the purchaser pay the severance taxes and deduct them from the amount paid to the seller. Thus, the amount of the taxes does not result in 'proceeds' as that term was used in Wheless and is ordinarily understood. We find, however, that appellant has the same ultimate responsibility for the taxes and receives the same benefit under Oklahoma's method of tax collection as it would in a state where the seller is obligated to pay the taxes directly and benefits from reimbursement by the purchaser. Here appellant still receives the benefit of 'tax reimbursement' and consequently the value of that benefit may be added to the amount appellant receives to determine the value of production to appellant for the purpose of computing the royalty."

authority to establish reasonable values for royalty purposes under the Mineral Leasing Act and Departmental regulations was affirmed.

The actual amount of proceeds received by appellant plus the amount of the State severance taxes paid by purchasers of the natural gas are a reasonable value for royalty purposes.

We fail to see how collection by the Federal Government of the royalty interest is a denial of equal protection where a private lessor chooses not to include the value of the tax paid by a purchaser in the computation of its lessee's royalty basis. That is a matter between the parties to a private lease agreement.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

Bruce R. Harris
Administrative Judge

We concur:

Bernard V. Parrette
Chief Administrative Judge

Edward W. Stuebing
Administrative Judge

